



California Public Employees' Retirement System
Investment Office
P.O. Box 2749
Sacramento, CA 95812-2749
TTY: (877) 249-7442
(916) 795-3400 phone
www.calpers.ca.gov

Agenda Item 3

November 14, 2011

TO: MEMBERS OF THE INVESTMENT COMMITTEE

- I. **SUBJECT:** October 2011 Policy Subcommittee Report
- II. **PROGRAM:** Total Fund
- III. **RECOMMENDATION:** That the Investment Committee Approve:
 - a. Global Equity – Revision of Internally Managed Global Enhanced Equity Strategies Policy
 - b. Corporate Governance – Revision of Global Principles of Accountable Corporate Governance
 - c. Absolute Return Strategies – Revision of Absolute Return Strategies (ARS) Policy
 - d. Asset Allocation/Risk Management – Revision of the Leverage Policy
 - e. Alternative Investment Management – Revision of the Alternative Investment Management (AIM) Program Policy

IV. ANALYSIS:

The Policy Subcommittee met on October 17, 2011 to review the proposed revisions to the policies listed above.

The revised policies are attached. Unless otherwise noted, the revised policies are presented as black-lined versions from the last approved policy by the Investment Committee. The black-line uses strike-out to indicate deletions and double underline to indicate additions. Single underline does not indicate a change; rather it indicates that the term is defined in the glossary.

Revision of the Internally Managed Global Enhanced Equity Strategies Policy

On August 15, 2011, the Investment Committee approved the graduation of the Internal Fan Long Only Strategy from the Global Equity Developmental Program to the existing line up of the Global Equity funds with a current proposed maximum capital allocation of 1% to complement the existing risk/return profile of

the Total Global Equity Portfolio. The policy revisions specify the investment approach for the Internal Fan Long Only portfolio and describe the three components the Program uses in the active equity investment process.

The Policy Subcommittee recommends approval of the revised Policy on Internally Managed Global Enhanced Equity Strategies.

Revision of the CalPERS Global Principles of Accountable Corporate Governance

The Global Principles of Accountable Corporate Governance provide the framework for CalPERS proxy voting responsibilities, corporate engagements and governance initiatives, which are intended to contribute to long-term sustainable risk adjusted investment returns. The recommended revisions include new and updated sections on:

- Board Talent Assessment and Diversity – highlights succession planning and broadening the director pool of talent to ensure access to the skills and experience needed to fulfill a company's strategy.
- Executive Compensation – supports CalPERS corporate engagements; supports "say on pay" voting which was introduced via Dodd-Frank; links compensation to business strategy, long-term performance, and risk hurdles.
- Integrity of Financial Reporting – supports integrated reporting, international convergence, the auditor's role, and enhanced reporting to investors, including environmental and social factors; recommendations based on corporate engagements.
- Risk Oversight – includes board accountability on matters related to the management of risk; recommendations developed from Financial Sector engagements.
- Charitable and Political Contributions – new principle added to the Corporate Responsibility section; supports board oversight, accountability, and transparency in corporate political spending and reporting.

The Policy Subcommittee completed two readings of the Principles in August and October 2011. Input was provided by the Policy Subcommittee and Board members.

In October 2011, public comments were received at both the Investment Committee and the Policy Subcommittee relevant to the Charitable and Political Contributions section.

The State Treasurer also provided suggested edits to the Charitable and Political Contributions section. The approved edits are shaded in the Principles on pages 18 and 19.

The CalPERS Legal Office will be responding to a letter from the law firm of Mayer Brown at the next Investment Committee meeting. A copy of the response will be provided to the committee.

The Policy Subcommittee recommends approval of the revised CalPERS Global Principles of Accountable Corporate Governance.

Revision of the Absolute Return Strategies Policy

The ARS (formerly “Risk Managed Absolute Return Strategies”) Policy is being revised to reflect changes to the program after its separation from the Global Equity Program. These changes are investment and administrative. The investment changes modified the risk target, modified the liquidity target, added a concentration limitation, and included the alignment of interest concepts.

The Policy Subcommittee recommends approval of the revised Policy on Absolute Return Strategies.

Revision of the Leverage Policy

At its September 2011 meeting, the Investment Committee approved the use of equitization associated with the ARS Program for a one year period. The ARS Program has a zero policy allocation and an approximate 2.5% actual allocation funded primarily through an underweight to Global Equity. Equitization, long positions in equity futures contracts or their equivalents, will restore the actual equity exposure closer to its policy allocation at the total fund level.

The proposed language establishes an upper limit on the notional exposure of equitization that is not fully collateralized with cash. Staff plans to scale the equitization so that the estimated equity exposure of the ARS Program and the noncash collateralized equitization combined does not exceed the market value of the ARS Program.

The Policy Subcommittee recommends approval of the revised Policy on Leverage.

Revision of the Alternative Investment Management Program Policy

The AIM Program is recommending three changes to the AIM Policy. The first change is to define the objective of the Program to be the same as the role of the Program as outlined in the ALM Workshop in November 2010. The second is to provide sub-asset class targets and ranges for the Program. Lastly, as an administrative matter, the benchmark language is being revised to reflect that the benchmark is specified in the Benchmark Policy.

The Policy Subcommittee recommends approval of the revised Policy on the Alternative Investment Management Program.

V. RISKS

Policy	Risks
Internally Managed Global Enhanced Equity Strategies	Loss of opportunity of investment returns if not approved.
CalPERS Global Principles of Accountable Corporate Governance	Emerging issues in corporate governance best practices would not be addressed if not approved.
Absolute Return Strategies	If accepted, there may be a slight reduction in opportunity set available to the program. Some of the forgone opportunities are already in the domain of other investment units. Therefore, net opportunity-set loss is expected to be zero.
Leverage	Equitization results in investment risk more similar to that of the policy portfolio. Equitization also results in basis risk, a chance that the returns of equity futures will not match the returns of the underlying equity indices less cash. Potential tracking error from basis risk during volatile markets could be as high as a few percentage points of the equitization program or a few basis points of total fund returns.
Alternate Investment Management Program	The additions should act as a risk mitigate by providing sub-asset class targets and ranges. Changing the objective of the Program to have the sole objective of enhancing equity returns does not guarantee that the objective will be met.

VI. STRATEGIC PLAN:

These items will further the following goals of CalPERS Strategic Plan:

- Goal I to exercise global leadership to ensure the sustainability of CalPERS pension and health benefit systems.
- Goal VIII to manage risks and volatility of assets and liabilities to ensure sufficient funds are available, first to pay benefits and second, to minimize and stabilize contributions.
- Goal IX to achieve long-term, sustainable, risk adjusted returns.

VII. RESULTS/COSTS:

The results of this item will provide CalPERS with enhanced efficiencies and ability to manage the overall portfolio. The revised policies will provide a foundation for compliance, accountability, and transparency.

KAMI NIEBANK
Division Chief
Policy and Business Support

JANINE GUILLOT
Chief Operating Investment Officer

JOSEPH A. DEAR
Chief Investment Officer